Supreme Court, U. S.
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Supreme Court of the United States

October Term, 1976

No. .....

76-790

MARVIN MILLER,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1976

No. .....

MARVIN MILLER,

Petitioner,

vs.

UNITED STATES OF AMERICA.

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The petitioner, MARVIN MILLER, prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on November 10, 1976.

OPINION BELOW

The opinion of the Court of Appeals, not yet reported,

appears in the appendix hereto (Appendix A). No opinion was rendered by the District Court for the Central District of California.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit was entered on November 10, 1976. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

I. In a criminal tax prosecution, are diverted corporate receipts to be taxed to the indicted shareholder under 26 U.S.C. § 61(a) (Gross income - General definition), or under 26 U.S.C. §§ 301(c) and 316(a) (Corporate distributions - Dividends defined)?

II. In a criminal tax prosecution, can the burden of going forward with the evidence be transferred to the indicted shareholder, requiring him to demonstrate that the application of §§ 301(c) and 316(a) generated no liability?

III. In a criminal tax prosecution where the burden has been transferred to the indicted shareholder to demonstrate his right to the application of §§ 301(c) and 316(a), have those sections been properly construed, when interpreted, to contain a new and implied provision that is inconsistent with the express provisions of those sections?

IV. Is the Ninth Circuit rule, in criminal tax cases, which defines the taxability of diverted corporate receipts to a shareholder under § 61(a), unconstitutionally vague when it asserts:

> **"The government establishes a *prima facie* case (including a tax liability) when it demonstrates that the taxpayer had unexplained funds which could be considered as income . . . "**

V. Is the mail fraud statute (18 U.S.C. § 1341) properly applied when used to charge federal and state income tax violations?

STATUTES AND CONSTITUTIONAL PROVISIONS INVOLVED

The relevant statutory and constitutional provisions are set forth in the appendix hereto (Appendix B); they include:

18 U.S.C. § 287	False, fictitious or fraudulent claims.
18 U.S.C. § 1341	Frauds and swindles.
26 U.S.C. § 61	Gross income defined.
26 U.S.C. § 301	Distributions of Property.
26 U.S.C. § 316	Dividend Defined.
26 U.S.C. § 317	Other Definitions.
26 U.S.C. § 7201	Attempt to evade or defeat tax.
26 U.S.C. § 7206(1)	Fraud and false statements.
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STATEMENT OF THE CASE

Petitioner was charged in a twenty-four count indictment with violations of 26 U.S.C. § 7201 (tax evasion), § 7206(1) (subscribing a false return), 18 U.S.C. § 287 (false claim for refund), and § 1341 (mail fraud). On July 15, 1975, following a court trial he was found guilty on twenty-two counts.[1] Twenty of the twenty-two counts upon which the petitioner was convicted were directly concerned with an alleged under reporting of his *personal* income tax liability as the result of corporate receipts which he diverted to himself during the years 1968, 1969 and 1970.[2]

At trial the petitioner did not contest his personal receipt of the corporate funds. He maintained, however, that under the applicable Internal Revenue Code provisions (26 U.S.C. §§ 301(c) and 316(a)), those funds were nontaxable returns of capital and/or capital gains against which he had uncontested capital losses. In short, he claimed to have owed no additional taxes.

To establish a personal tax liability, the government seemingly relied upon *Davis v. United States,*[3] 226 F.2d 331 (CA-6 1955), *cert. denied,* 350 U.S. 965, which holds that diverted corporate receipts are to be taxed to the

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[1]One count was dismissed on motion of the government before final argument, and the petitioner was found not guilty as to one other count.

[2]The remaining two counts on which the petitioner was convicted charged him with false subscription of his corporate returns. He maintains that the trial court's gross error with respect to the applicable law concerning the twenty personal counts tainted the court's findings on the two corporate counts.

[3]See the opinion of the Court of Appeals for the Ninth Circuit (Appendix A, page 9).

offending shareholder under the general gross income provisions of 26 U.S.C. § 61(a), and without regard to the otherwise applicable corporate distribution requirements of §§ 301(c) and 316(a).

The trial court rejected the petitioner's asserted defense under §§ 301(c) and 316(a) despite the uncontroverted evidence which showed the petitioner's corporation had no earnings and profits from which to pay a dividend during 1968, 1969 and 1970.

At trial, the petitioner did not rest upon his then asserted belief that it was the government's burden of proof to demonstrate under §§ 301(c) and 316(a) that the petitioner's corporation had sufficient earnings and profits from which to pay a dividend and consequently establish an additional personal tax liability due from him. As indicated above, the petitioner demonstrated at trial, without a shred of contradictory evidence offered by the government[4], that his corporation had no earnings and profits. Thus, the petitioner showed that his receipt of the corporate funds in question produced no material tax consequence to him personally.

The government never contended that the facts which gave rise to the petitioner's diversion of corporate receipts produced an additional *corporate* tax liability in the second of the two corporate years in question. The trial court acquitted the petitioner as to the count which charged an additional *corporate* tax liability in the first of the two corporate years.

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[4]The Court of Appeals' oblique reference to the contrary at footnote 14 (Appendix A, page 14) is in error. The government expert witness did not at any time testify there were corporate earnings and profits to support a constructive dividend for *criminal* tax purposes.

The opinion of the Court of Appeals for the Ninth Circuit acknowledged the petitioner's right to demonstrate that under the provisions of §§ 301(c) and 316(a) he owed no additional tax liability. However, in interpreting those provisions, the Ninth Circuit made novel rulings of law which resulted in affirming the District Court's judgment. It is the validity of those newly announced rules that constitutes the principal issue being challenged in this petition.

The Circuit Court's approval of the "salary" designation to classify the petitioner's receipt of diverted corporate funds was predicated upon a threshold determination that the petitioner could not sustain his burden of proof under §§ 301(c) and 316(a). It is that threshold determination which lies at the very heart of this appeal.

REASONS FOR GRANTING THE WRIT

I

There Is A Major Conflict Among The Circuits Whether, In A Criminal Tax Fraud Case, Diverted Corporate Receipts Should Be Taxed To An Indicted Shareholder Under The Provisions Of 26 U.S.C. § 61(a) Or Under 26 U.S.C. §§ 301(c) and 316(a).

The Fifth Circuit, in *Bernstein v. United States,* 234 F.2d 475, 482 (1956), holds that in a criminal tax fraud proceeding, diverted corporate receipts are taxed, if at all, to the offending shareholder under the provisions of §§ 301(c) and 316(a). The First Circuit holds likewise, *Currier v. United States,* 166 F.2d 346, 348 (1948). The Second Circuit, in *United States v. Leonard,* 524 F.2d 1076, 1083 (1975), petition for certiorari filed January 16, 1976 and pending, clearly adheres to the application of §§ 301(c) and 316(a) in the context of a criminal tax fraud proceeding. *Leonard*, however, imposes a rather minimal burden upon the government to bring its proof within those provisions.

On the other side of the conflict, the Sixth Circuit, in *Davis v. United States,* 226 F.2d 331, 335 (1955), *cert. denied,* 350 U.S. 965, unequivocably asserts § 61(a) is the only applicable code section under which diverted corporate receipts are taxed to a shareholder in a criminal tax fraud proceeding. The Eighth Circuit, in *United States v. Hartman,* 245 F.2d 349, 353 (1957), expressly follows *Davis,* and, presumably, so does the Third Circuit in *Goldberg v. United States,* 330 F.2d 30, 38 (1964), *cert. denied,* 377 U.S. 953.

The Ninth Circuit in the instant case has seemingly invoked yet a third side to the conflict. It holds that *both* § 61(a) as well as §§ 301(c) and 316(a) are applicable. Novelly, it permits the government to establish a prima facie case under § 61(a) and then *transfers* the burden to the indicted shareholder to make a *showing* that the mandates of §§ 301(c) and 316(a) should supercede the application of § 61(a). The Ninth Circuit's unusual treatment will be discussed further below.[5]

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[5] It is also worthy of note that the Ninth Circuit, in part, bottomed its approach of taxing diverted corporate receipts to a shareholder under § 61(a), upon an unsupported principle first enunciated in *Drybrough v. Commissioner of Internal Revenue,* 238 F.2d 735, 737 (CA-6 1956). That case held by implication that the applicable rules in establishing a tax liability in criminal tax fraud proceedings (e.g., § 61(a)) could be different from the rules applied in a civil tax fraud proceeding (e.g., §§ 301(c) and 316(a). The Circuits are split widely over the viability of this doctrine. See *DiZenzo v. Commissioner of Internal Revenue,* 348 F.2d 122, 126 (CA-2 1965), and the cases cited therein. This dichotomous approach obviously can produce a different income tax liability for the same shareholder under the same set of facts but differing only because of the forum in which he finds himself called to litigate his tax liability. Such a rule is manifestly a denial of due process.

Patently, the application of the § 61(a) shotgun provision to the taxation of diverted corporate receipts ignores the time honored rule of statutory construction which holds that the general language of a statute will not apply to a matter specifically dealt with in another part of the same enactment. *Mac Evoy v. United States,* 322 U.S. 102, 64 S. Ct. 890, 894, 88 L. Ed. 1163 (1944).

Additionally, the Sixth Circuit in *Davis, supra,* which was the first Circuit to hold § 61(a) as the appropriate section under which to tax diverted corporate receipts, relied upon *Rutkin v. United States,* 343 U.S. 130, 72 S. Ct. 571, 96 L. Ed. 833 (1951), in support of its position. That reliance was misplaced. *Rutkin* had nothing to do with diverted corporate receipts, shareholders, or §§ 301(c) and 316(a).[6]

II

Where There Are Two Equally Applicable Statutes Under Which To Tax Diverted Corporate Receipts, The Government Cannot Select That Statute Which Produces A Tax Liability And Then Transfer The Burden Of Proof To The Defendant To Demonstrate That Under The Other Statute, No Tax Liability Exists.

The burden of proof in a criminal case is never on the defendant, *Johnson v. Florida,* 391 U.S. 596, 598, 88 S. Ct.

[6]In none of the decisions by the Third, Eighth and Ninth Circuits, all of which have uncritically set forth the *Davis* rule, has there been an examination of the *Davis* court's reasoning to devine the rationale for its refusal to follow the express language of Internal Revenue Code §§ 301(c) and 316(a). Hopefully, this Court will do so.

1713, 20 L. Ed. 838 (1968). Nevertheless, the Ninth Circuit holding in the instant case has, in fact, shifted the government's burden of proof to the petitioner.

Those Circuits which follow the *Davis* rule subscribe to but a *single* applicable theory under which to tax diverted corporate receipts in a criminal proceeding, i.e., the provisions of § 61(a). They would admit no proof by an indicted shareholder that his corporation lacked the earnings and profits necessary under §§ 301(c) and 316(a) to support a finding of a constructive dividend. Similarly, those Circuits which are in conflict with the *Davis* rule, and which require the government to follow the express language of §§ 301(c) and 316(a), also subscribe to but a *single* applicable theory under which to tax diverted corporate receipts. It is only the novel Ninth Circuit holding which admits that *both* § 61(a) as well as §§ 301(c) and 316(a) may be applicable.[7] By acknowledging that either of the above sections may be applicable and then permitting the government to establish a tax liability solely under § 61(a) where the proof is less complicated,[8] the burden of proof has been impermissively transferred to the defendant. The latter must now prove his innocence by demonstrating that under §§ 301(c) and 316(a) his distribution was nontaxable. This can work to an anomalous result as the facts showed in the petitioner's

[7]The § 61(a) application is found in the language of the opinion (Appendix A, page 13) at footnote 13. The §§ 301(c) and 316(a) application is expressed as follows:

> "In holding that the constructive distribution rules should not *automatically* be applied, it is not herein asserted that diverted funds could never be a return of capital. However, to constitute the latter, there must be some demonstration . . . " (Emphasis supplied). (Appendix A, page 13).

[8] " . . . unexplained funds which could be considered as income . . . " At note 13 (Appendix A, page 13).

case. Under § 61(a) the government proved a tax liability while under §§ 301(c) and 316(a) the petitioner proved there was no tax liability. When the government is required to address its proof to all of the applicable sections of the Code, not only will the defendant be spared from carrying a burden that is not properly his own, but, further, conflicting results as evidenced in the petitioner's case will be avoided.

III

An Interpretation That Internal Revenue Code §§ 301(c) And 316(a) Are Operative In A Criminal Tax Proceeding Only If A Shareholder Intended A Return Of Capital Is Contrary To The Express Language Of Those Sections.

Internal Revenue Code § 301(c)(2) states in pertinent part:

> " . . . That portion of the distribution which is not a dividend *shall* be applied against and reduce the adjusted basis of the stock." (Emphasis supplied).

The cases are legion which demonstrate that §§ 301(c) and 316(a) operate totally without regard to the disclosed or undisclosed intentions of the shareholder. *C.I.R. v. Riss, et al.*, 347 F.2d 161, 167 (CA-8 1967); *Noble v. C.I.R.*, 368 F.2d 439, 442-443 (CA-9 1966); *Longsfield v. Commissioner*, 241 F.2d 508, 511 (CA-5 1957); *United States v. Jolly*, 229 F.2d 180 (CA-6 1956), affirming the District Court case reported at 55-2 USTC 9725. The Ninth Circuit rule in the

instant case[9], that §§ 301(c) and 316(a) are not operative unless:

> " . . . [there is] some demonstration on the part of the taxpayer and/or the corporation that such distributions were *intended* to be a return [of capital]" (emphasis supplied),

is clearly contrary to the express provisions of those sections and every and all interpretations thereof.

The petitioner's conviction under § 7201, *et cetera*, for allegedly evading his tax responsibilities, necessarily incorporates within those penal statutes other provisions of the Internal Revenue Code that define income. It is improper in the context of a *criminal* tax proceeding that the Ninth Circuit should seek to expand the meaning of §§ 301(c) and 316(a) to catch the unwary. Criminal statutes must be strictly construed. No offense may be created except by the words of Congress used in their usual or ordinary sense. *United States v. Alpers*, 338 U.S. 680, 70 S. Ct. 352, 353 (1950).

IV

An Interpretation That Internal Revenue Code § 61(a) Permits The Government, In A Criminal Tax Proceeding, To Prove A Tax Liability To A Shareholder By The Mere Possession of Unexplained Corporate Funds Which Could Be Considered Income, Is Unconstitutionally Vague.

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[9] See the opinion of the Court of Appeals for the Ninth Circuit (Appendix A, page 13).

A statute, though plain and unambiguous on its face, may, when applied, violate due process of law, *United States v. Spector*, 343 U.S. 169, 171, 72 S. Ct. 591, 96 L. Ed. 863, *rehearing denied*, 343 U.S. 951, 72 S. Ct. 1040, 96 L. Ed. 1088 (1952).

The Ninth Circuit has concluded:[10]

> " . . . the government establishes a *prima facie* case [here] when it demonstrates that the taxpayer had *unexplained* funds which *could be* considered as income which the taxpayer fails to report in his return." (Emphasis supplied). Citing: *United States v. Garcia*, 412 F.2d 999, 1001 (CA-10 1969); *Gendelman v. United States*, 191 F.2d 993, 996 (CA-9 1951), *cert. denied*, 342 U.S. 909 (1952).

Such an interpretation of § 61(a) is offensive for several reasons. First of all, literally thousands of shareholders in closely held corporations will, from time to time, be found in possession of "unexplained funds which could be considered income." Are they all to be criminally indicted? In the alternative, should the government be permitted to pick and choose among this vast population of target shareholders, selecting that member which it deems uniquely deserving to defend himself against an indictment?

Additionally, the aforesaid *prima facie* rule is perplexing because of the peculiar reference to "unexplained funds." Clearly, the facts in the instant case showed the funds in the petitioner's possession were corporate receipts; hence, they were not "unexplained." An analysis, however, of *Garcia*,

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[10] See opinion at note 13 (Appendix A, page 13).

supra, and *Gendelman*, *supra*, will demonstrate they were *net worth* cases which dealt with the customary *unexplained bulge* in the taxpayer's net worth. There is no logic in permitting the importation of net worth concepts into specific item cases (i.e., corporate diversions) without making a shambles of the significant distinctions that underlie those unrelated methods of proof.

V

Congress Did Not Intend The Mail Fraud Statute (18 U.S.C. § 1341) To Be Applied To The Prosecution Of Federal And State Income Tax Violations.

The Ninth Circuit rule to the contrary[11] now opens the door for the Postal authorities to usurp the functions of the Internal Revenue Service in policing the tax laws.

Pursuant to written instructions by the Internal Revenue Service and state taxing authorities, almost all tax returns are mailed to their appropriate Service Centers. Consequently, almost every tax return will fall within the jurisdiction of the Post Office Department.

More significantly, the comprehensive Internal Revenue Code statutory scheme, under Chapter 75, 1954 Code, which sets forth a hierarchial system of criminal sanctions can now be flatly ignored in the prosecution of income tax violations. The government can conveniently opt for the broader language of 18 U.S.C. § 1341 which permits a conviction of anyone who " . . . devised or intend[ed] to devise any

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[11] See opinion at note 17 (Appendix A, page 16).

scheme to defraud . . ."[12]. Since, presently, there is a conspicuous absence of case law applying § 1341 to federal income tax violations, a spate of litigation must be assumed to follow shortly unless this Court limits such prosecutions to the traditional penal statutes. See *United States v. Henderson*, 386 F. Supp. 1048, 1050-1055 (DC SDNY 1974), for an enlightened discussion on this issue.

CONCLUSION

For the reasons set forth above, it is respectfully suggested that a Writ of Certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit in this matter.

Respectfully submitted,

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[12] See 18 U.S.C. § 1341 (Appendix B, page 17).

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UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA, *Appellee,* vs. MARVIN MILLER, *Appellant.*	No. 75-3016 OPINION

[November 10, 1976]

Appeal from the United States District Court
for the Central District of California

Before: BARNES and ELY, Circuit Judges,
and VAN PELT,* District Judge.

BARNES, Senior Circuit Judge:

This is an appeal from appellant's conviction on 22 counts of a 24-count indictment charging tax evasion (26 U.S.C. § 7201), making and subscribing false tax returns (26 U.S.C. § 7206(1)), mail fraud (18 U.S.C. § 1341), and filing false claims against the United States (18 U.S.C. § 287).[1]

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*The Honorable Robert Van Pelt, Senior Judge, District of Nebraska, sitting by designation.

[1]The twenty-four counts were:

Count	*Code Section*	*Offense*
A.	18 U.S.C. § 1341 (Mail Fraud)	The use of the U.S. Postal Service to send and deliver the following false returns.
1	"	Miller's personal U.S. Tax return for 1969.
2	"	Mrs. Miller's personal U.S. tax return for 1969.
3	"	Covina's corporate U.S. Tax return for the fiscal year ending May 31, 1970.

APPENDIX A

During the period of January 1, 1968, through June 1, 1970, Miller operated Covina Publications, Inc. ("Covina") and two related companies. The primary business of Covina was the sale

Count	*Code Section*	*Offense*
4	18 U.S.C. § 1341 (Mail Fraud)	Millers' joint U.S. tax return for 1970.
5	"	Miller's personal California state tax return for 1970.
6	"	Mrs. Miller's personal California state tax return for 1970.
7	"	Millers' amended joint personal U.S. tax return for 1970.
B.	26 U.S.C. § 7201 (Tax Evasion)	Pursuant to a willful attempt to evade taxes, the preparation and filing of the following false returns:
8	"	Covina's corporate tax return for the fiscal year ending May 31, 1969.
11	"	Miller's personal U.S. tax return for 1968.
13	"	Mrs. Miller's personal U.S. tax return for 1968.
15	"	Miller's personal U.S. return for 1969.
18	"	Mrs. Miller's personal U.S. tax return for 1969.
21	"	Millers' joint U.S. tax return for 1970.
C.	26 U.S.C. § 7206(1) Subscribing a False Tax Return	Signing and/or preparing a fraudulent return for:
9	"	Covina for the fiscal year ending May 31, 1970.
10	"	Covina's tax return for fiscal year ending May 31, 1970.
12	"	Miller's personal U.S. tax return for 1968.
14	"	Mrs. Miller's personal U.S. tax return for 1968.

of adult books, films and devices to the general public by mail order and to wholesale distributors. Miller dominated and controlled Covina, for which he received a set salary. He purchased all issued stock of the corporation for $128,000.00, which stock was held in the names of his four children, and (perhaps) his wife.[2]

In the course of the trial, it was not disputed that for the fiscal year ending May 31, 1969, approximately $562,000.00 of mail order and distributors receipts were not recorded as sales on the corporate books, or reported in the corporate tax returns filed

Count	*Code Section*	*Offense*
16	26 U.S.C. § 7206(1) Subscribing a False Tax Return	Miller's personal U.S. tax return for 1969.
22	"	Miller's joint U.S. tax return for 1970.
24	"	Millers' amended joint U.S. tax return for 1970.
D.	18 U.S.C. § 287 Filing a False Claim against the United States	The claim for a refund for overpayment of taxes incorporated in:
17	"	Miller's personal U.S. tax return for 1969.
20	"	Mrs. Miller's personal U.S. tax return for 1969 which included a claim for a refund.
23	"	Millers' joint U.S. tax return for 1970 which included a claim for a refund.
25	"	Millers' amended joint U.S. tax return for 1970 which included an additional claim for refund.

E. No Count 19 was ever listed

The government dismissed count 3. The defendant was found not guilty on count 8.

[2]At the trial, appellant stated his four children and William Miller were the stockholders, but that he was the real owner and operator of the business. (R.T., p. 1120) In his brief, appellant alleges "the nominal ownership of his corporations was in the name of his wife and children." (Appellant's Brief, pp. 11-12).

by Miller. About $298,000.00 was likewise omitted as sales from the books and tax returns for the fiscal year ending May 31, 1970. Such sums were instead recorded either as loans from the defendant and from banks to the corporations, as payments on account from various wholesale customers, or as "exchanges" (intercompany transfers). Evidence submitted by the government indicated that most of the money was deposited in various business and personal bank and savings accounts established by Miller under various names including those of his wife and children.

During the same period (5/31/68 to 5/31/70) Miller received, in addition to his salary, other economic benefits from Covina, the latter making periodic checks to Miller and paying virtually all of his personal bills (from the mortgage on his home to his "Book-of-the-Month" Club obligations). The total of such payments was in excess of $197,000.00 which was recorded on Covina's books as repayments of loans. Miller did not report any of the money on his own, or his wife's, two years of separate, and one year of joint, returns. (Calendar years 1968, 1969, and 1970).

For the fiscal years considered herein, Miller asserted that Covina had been a losing venture. In the year ending May 31, 1969, Covina reported a net loss of approximately $216,000.00. At trial, an expert witness for the defendant argued that due to an erroneous entry into the books of a sale of a mailing list for $500,000.00, which was never consummated, the loss for the year should have been reported as $681,000.00. Likewise, for the fiscal year ending May 31, 1970, Covina reported a loss of $697,000.00. The Internal Revenue Service commenced an audit of the books of the defendant's companies in 1971.

At trial, Miller admitted that he had instructed his accountant to "scramble" the corporate books. However (for what such a self-serving statement is worth), he later testified that the sole purpose of all of his concealment activities was to hide his income from his creditors and not to cheat the government.[3] Miller

[3]Covina was subject to a series of prejudgment attachments which culminated in 1971 when the attaching creditor obtained a judgment, with costs, in excess of one million dollars. *See* in this regard, *Western Bd. of Adjustors, Inc.* v. *Covina Pub. Inc.*, 9 Cal. App. 3d 659, 88 Cal. Rptr. 293 (1970).

stated that he had instructed his accountant to keep track of the real figures and file proper returns. Miller also asserted (for what it is worth) that he signed and filed the returns without really studying them, relying instead on his accountant's alleged assurances that "everything is okay."

At the close of the trial, one count of mail fraud (count 3) was dismissed upon the motion of the government. The trial judge found Miller not guilty of count 8 (tax evasion based on Covina's 1969 tax return). While there was evidence that Covina's tax return for the 1969 fiscal year was fraudulent, there was insufficient evidence to prove beyond a reasonable doubt that there would have been any tax due for that year (even if the $562,000.00 was added to Covina's income), due to the fact that the $500,000.00 sale was never shown to have occurred during the year.[4] Miller was found guilty on all the remaining counts.

On appeal, Miller raises an extremely technical argument. He asserts that the $197,000.00 he received from Covina *must* be treated as a constructive corporate distribution to a shareholder and be governed by §§ 301(c) and 316(a) of the Internal Revenue Code ("I.R.C.").[5] As Covina was not shown to have had any earnings and profits during the period under consideration, Miller argues that the $197.000.00 represented primarily a return of capital[6] and hence the distribution had no substantial tax

[4]It was demonstrated at trial that even if the $298,000.00 of diverted income were actually added to Covina's 1970 tax return, no tax liability would have resulted due to corporate losses of over $516,000.00 for that year.

[5]According to I.R.C. § 316(a), a distribution of property by a corporation to its shareholders constitutes a dividend to the extent it is made out of earnings and profits of the corporation. I.R.C. § 301(c) provides that any distribution of property made by a corporation to a shareholder with respect to its stock shall be treated as a dividend if the distribution comports with the definition set out in I.R.C. § 316(a), and shall be included in gross income. Insofar as a portion of the distribution is not covered by earnings and profits, it is to be treated as a return of capital and the basis for the stock is reduced accordingly. If the distribution exceeds the adjusted basis of the stock, the excess is normally considered as capital gain. I.R.C. § 301(c)(3).

[6]Dividends are classified as gross income. I.R.C. §§ 301(c)(1) and 61(a)(7). A return of capital is normally not a taxable event. Capital gains treatment may produce tax obligations. *See*, I.R.C. § 1201.

consequences.[7] Consequently, he suggests that his signing and filing of his own and his wife's separate and joint tax returns and his use of the United States Postal Service to deliver them do not violate any statutory provisions. Because the trial court did not specifically find that Covina owed any additional taxes, even if the omitted income were added to the calculations for the years in question, and because the $197,000.00 is alleged to be not taxable to him, Miller further argues that there is insufficient evidence to establish that he intentionally filed false corporate returns for Covina.[8]

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[7]However, Miller's expert witness testified that the basis for Miller's stock in Covina was only $128,200.00 (R.T., p. 1196). Consequently, $68,800.00 of the $197,000.00 would have been subject to capital gains treatment. According to Miller's calculations, given his claims of capital losses, he concluded that ultimately he owed taxes only for a long term capital gain of $1,699.00 for 1970.

It is noted herein that even if Miller's constructive distribution theory were accepted, Miller could nevertheless be convicted on several of the counts so long as his intent to falsify his return is found. *See* discussion of 26 U.S.C. § 7206(1) in footnote 8, *infra*. As an example, Miller's own conclusion was that he had tax liability for a long term capital gain of $1,699.00 for 1970. That amount is substantial enough to constitute a violation of 26 U.S.C. § 7201, especially when considered in light of the claim for a tax refund of more than $4,000.00 which he made that year and which was later increased by an additional $210.00 when he filed an amended 1970 return. *See, Marks v. United States*, 391 F.2d 210, 211 (9th Cir. 1968) (where the taxpayer was convicted for cheating on his tax return for failure to report a total net taxable income of $1,877.43 for which the tax would have been $375.49). As Miller's willful and intentional efforts to evade his taxes is well documented in the record (an aspect which the defendant's briefs do not adequately attempt to dispel), Miller's technical arguments are not persuasive.

[8]Miller contends that because the trial court found no tax obligation for Covina for 1969 and none was asserted for 1970 even if the diverted receipts were added to the calculations for those years (*see* footnote 3 and concomitant text), he therefore had no motive to file false corporate returns for Covina. However, two theories refute that contention. First, the concealment of the corporate receipts was a necessary element to their diversion for his own personal use. It follows that in order to hide their withdrawal by him, Miller had concealed their real nature as income to the corporation. Secondly, it is well established that under 26 U.S.C. § 7206(1) it is not the evasion of taxes which is the prohibited offense but the falsification of tax statements. *United States v. Bishop*, 412 U.S. 346 (1973);

ISSUES:

(1) Was the $197,000.00 diverted by Miller gross income to him or a form of constructive corporate distribution?

(2) Is there substantial evidence to support Miller's conviction on the various counts?

This case raises the primary problem of characterizing, for the purposes of *criminal* tax proceedings, the nature of funds diverted by a taxpayer from his close corporation. Normally, such categorization is relatively unimportant in criminal cases since the primary question is not the amount of the evasion but whether the taxpayer intended to evade and defeat his taxes. *Goldberg v. United States*, 330 F.2d 30, 40 (3rd Cir.), *cert. denied*, 377 U.S. 953 (1964); *Simon v. C.I.R.*, 248 F.2d 869, 876 (8th Cir. 1957); *Drybrough v. C.I.R.*, 238 F.2d 735, 737 (6th Cir. 1956). *See also*, Gardner, The Tax Consequences of Shareholder Diversions in Close Corporations, 21 Tax L.Rev. 223, 226-27 (1966). Such diverted funds are typically considered as constructive corporate distributions and classified as dividends pursuant to I.R.C. §§ 301(c) and 316(a). *See, e.g., O'Rourke v. United States*, 347 F.2d 124, 127 (9th Cir. 1965). Because dividends are includable in gross income, I.R.C. § 61(a)(7), the end result is a conclusion that the diverted funds constitute income to the taxpayer which he must report or be held to have evaded his tax obligations. *O'Rourke, supra*, 347 F.2d at 127-28; *Hartman v. United States*, 245 F.2d 349, 352-53 (8th Cir. 1957). However, where, as here, there are no corporate earnings and profits from which a dividend could be paid, the classification of the diverted funds becomes more critical.[9] If the corporation

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Edwards v. United States, 375 F.2d 862, 865 (9th Cir. 1967). That the falsity may not relate to the computation of the correct tax liability is not a determining factor. *Sirave v. United States*, 377 F.2d 469, 472 (1st Cir. 1972); *Cf. United States v. Abbas*, 504 F.2d 123, 126 (9th Cir. 1974), *cert. denied*, 421 U.S. 988 (1975). Here, Miller knew that he had diverted over $750,000.00 in corporate income. Even if such diversion had no immediate tax consequences, Miller was nevertheless obligated to report such receipts to the government.

[9]It was argued by Miller that because Covina's losses for its 1969 and 1970 fiscal years so far exceeded its income (even if the diverted funds are included in the calculations), such losses precluded the possibility of any earnings and profits for those years. However, due to the fact that Miller ordered the corporate books to be "scrambled," the

has no earnings and profits and if the taxpayer's cost basis of the stock exceeds the amount of the diverted funds, the application of the constructive distribution rules as urged by appellant would permit the taxpayer to escape conviction by enabling him to assert that the diverted funds were a constructive return of capital and hence non-taxable as income.

Defendant Miller contends that the trial court has committed reversible error as to all of the counts due to its initial characterization of the $197,000.00 in direct and indirect payments to him as salary rather than constructive corporate distributions. While Miller's contention raises some interesting questions as to the extent of wrongdoing required to sustain convictions for tax evasion (26 U.S.C. § 7201), subscribing false tax returns (26 U.S.C. § 7206(1)), filing false claims against the United States (18 U.S.C. § 287) and mail fraud (18 U.S.C. § 1341), such questions need not be considered if the conclusion is reached that the trial court was not in error in its initial characterization.[10] Consequently, those issues are not dealt with herein because the trial court's characterization is not in error.

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trial judge concluded that no showing of an absence of earnings and profits could be obtained by an examination of the books. As to Miller's arguments as to the adequacy of the books, *see* footnote 13, *infra*.

[10]To sustain a conviction for tax evasion, 26 U.S.C. § 7201, it must be shown that the defendant willfully attempted to evade the tax, that there was a tax deficiency, and that the defendant committed some affirmative act to that end, *Sansone v. United States*, 380 U.S. 343, 351 (1965). *O'Rourke v. United States*, 347 F.2d 124, 126 (9th Cir. 1965). A violation of 26 U.S.C. § 7206(1) is complete when the taxpayer files a return "which he does not believe to be true and correct as to every material matter." *United States v. Bishop*, 412 U.S. 346, 350 (1973). That the falsity does not directly relate to the calculation of the correct tax liability does not necessarily affect its materiality. *United States v. Abbas*, 504 F.2d 123, 126 (9th Cir. 1974), *cert. denied*, 421 U.S. 988 (1975); *United States v. Edwards*, 375 F.2d 862, 865 (9th Cir. 1967). Mail fraud, 18 U.S.C. § 1341, necessitates a scheme to defraud and the mailing of a letter for the purpose of executing the scheme. *Pereira v. United States*, 347 U.S. 1, 8 (1954). The filing of a false tax return pursuant to a scheme to obtain an unjustified tax refund is sufficient to establish a violation of presenting a false claim against the United States under 18 U.S.C. § 287. *United States v. Lopez*, 420 F.2d 313 (2nd Cir. 1969); *Kercher v. United States*, 409 F.2d 814 (8th Cir. 1969).

All of the above offenses require an intent to evade taxes (which in this case is equivalent to an intent to defraud the government,

As support for his argument that funds diverted by a taxpayer from his close corporation must be treated as constructive distributions, Miller basically argues that most courts have traditionally applied such a rule and to do otherwise in the present situation would lead to various inconsistencies in the tax law. Several *civil* tax decisions are cited. *E.g., Noble v. C.I.R.*, 368 F.2d 439, 442 (9th Cir. 1966); *DiZenzo v. C.I.R.*, 348 F.2d 122, 126 (2nd Cir. 1965); *Clark v. C.I.R.*, 266 F.2d 698, 707 (9th Cir. 1959); *Simon, supra.*

Conversely, the government argues that the diverted funds must be treated as income to the taxpayers without regard to any tangential factors such as earnings and profits of the corporation. The government primarily relies on *Davis v. United States*, 226 F.2d 331 (6th Cir. 1955), *cert. denied*, 350 U.S. 965 (1956). In *Davis*, a *criminal* tax proceeding, it was held that where the taxpayer diverted for his own use the income of a wholly-owned corporation, such income was taxable to him irrespective of whether the corporation had sufficient surplus to make the distribution as a dividend. In so holding, the court stated that:

> Appellant contends in this case that, whether the cash which he took from his wholly owned corporation was a "taxable gain," depends upon whether the corporation had

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especially when Miller is faced by his claims for tax refunds). That requisite element is sufficiently demonstrated in the record. However, insofar as those offenses require additional elements, the problem arises. If Miller's argument as to constructive corporate distributions were adopted, the situation would arise where Miller would be found: (1) to have willfully attempted to evade his tax obligations by hiding the diverted funds as non-taxable repayments of loans, (2) to have engaged in activities necessary to complete his scheme, *e.g.*, signing and mailing his presumed false returns, (3) but, due to the after-the-fact categorization of the diverted funds as returns of capital, not to have had taxable income for at least some of the years in question. (The $197,000.00 payments were spread over the three year period from 1968 to 1970. To the extent that they would have exceeded Miller's $128,200.00 basis in the stock, such excess payments would have occurred initially in the latter part of 1969 and in 1970.) Consequently, questions would arise as to whether Miller could be convicted of 26 U.S.C. § 7201, which has been interpreted as requiring a tax deficiency to be present, or of 18 U.S.C. §§ 287 and 1341.

sufficient surplus to cover a dividend distribution, as otherwise there would be no way in which he could receive such cash as a gain taxable to him and, since there is no proof of such a surplus, he is only a holder of the cash for the benefit of the corporation. However, it does not make any difference whether he received it as a legal distribution of cash as the result of a dividend, or whether he took it fraudulently, using his wholly owned corporation with its false bookkeeping methods and concealment of sales and receipts to hide the fact that he was secretly acquiring from this source of cash, over which he exercised command, control, and dominion, and from which he realized economic gain and benefit. For "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid." *Corliss v. Bowers*, 281 U.S. 376, 378, 50 S.Ct. 336, 74 L.Ed. 916. It is the command over property and the enjoyment of its economic benefit which are recognized as a proper basis for taxation. *Burnet v. Wells*, 289 U.S. 670, 53 S.Ct. 761, 77 L.Ed. 1439; *Helvering v. Horst*, 311 U.S. 112, 61 S.Ct. 144, 85 L.Ed. 75. It is not necessary to go into the legality of the so-called distribution by appellant's wholly owned corporation to himself, or his extraction of the cash from the corporation, as it clearly appears that through the fraudulent transactions in which he was engaged, he received the cash over which he had complete control, which he took as his own, treated as his own, which resulted in economic value to him, and for which he probably never would have been required to account, had it not been for the discovery of the fraud on the revenue which he was perpetrating. *Briggs v. United States*, 4 Cir., 214 F.2d 699.

226 F.2d at 334-35.

Davis has been generally followed in the review of *criminal* tax proceedings by the circuit courts. *Goldberg, supra*, 330 F.2d at 40 (3rd Cir.); *Hartman, supra*, 245 F.2d at 352-53 (8th Cir.), *and see* also Lofts and Lofts, 285 T.M., Tax Crimes—Evasion of Another's Tax and Defenses, p. A-5 (1973). *But see, Bernstein v. United States*, 234 F.2d 475 (5th Cir.), *cert. denied*, 352 U.S. 915 (1956). And, at least two circuits have refused to follow *Davis* in the context of *civil* tax proceedings. *DiZenzo, supra*,

348 F.2d at 126 (2nd Cir.); *Simon, supra*, 248 F.2d at 876 (8th Cir.).[11]

[11]Appellant (after all briefs were filed, but prior to argument) cited the case of *United States v. Leonard*, 524 F.2d 1076 (2nd Cir. 1975), *cert. den.*, 44 USLW 3624, May 4, 1976 to demonstrate that the Second Circuit has rejected the holding of *United States v. Davis, supra*, and is now willing to apply the standard set out in the civil tax fraud case of *DiZenzo v. C.I.R., supra*, which requires that funds diverted by a shareholder from his wholly-owned corporation should be treated as corporate distributions rather than as ordinary income.

The support which *Leonard* provides the appellant's contention is difficult to determine, and is most certainly a weak reed. In *Leonard*, the defendant had formed a corporation to which he transferred the business of his sole proprietorship. He continued to cash several of the checks received by him after the formation of the corporation to his own account even though they belonged to the corporation at that point. The government contended that the funds were embezzled income. The defendant argued that under *DiZenzo* the funds were to be treated as constructive dividends. The court stated that: "Acceptance of this [defendant's argument] still does Leonard no good unless, as he asserts, Leonard, Inc. had no earnings and profits. . . ." *Leonard, supra*, 524 F.2d at 1083. The court went on to hold that once the government has established that the defendant had received unreported funds the burden of proof is to demonstrate that the funds were constructive dividends rather then embezzled funds shifted to the defendant.

> In prosecutions for income tax violations, production of a rather slight amount of evidence by the Government, here the proof of receipt of what are charitably characterized as constructive dividends rather than embezzled funds, may transfer the burden of going forward to the defendant. . . . *Id.* citing *Holland v. United States*, 348 U.S. 121, 137-139 (1954).

It was concluded that the defendant failed to introduce sufficient evidence of an absence of earnings and profits to even warrant consideration by the jury of the defendant's contention that the diverted funds were returns of capital and hence non-taxable. Defendant's conviction was affirmed on two counts of violating § 7206(1) of 26 U.S.C. (I.R.C. 1954), "Subscribing a False Tax Return"; which counts are similar to counts 9, 12, 14, 16, 22 and 24 in this case.

Leonard is not particularly helpful to appellant herein. First, the Second Circuit in *Leonard* relied on a civil tax fraud case for support of the proposition that the diverted checks were to be treated as constructive distributions. As discussed in this opinion, such reliance in a criminal tax fraud case is not well founded. Second, the court in *Leonard* did not categorically accept the defendant's proposition that *DiZenzo* had to be applied but rather noted that even if it were to accept the defendant's contention, the defendant nevertheless failed to

This court must decide whether the rules of constructive distribution are to be automatically applied in the present situation, a review of a *criminal* tax proceeding. In civil tax cases the purpose is tax collection and the key issue is the establishment of the amount of tax owed by the taxpayer. In a criminal tax proceeding the concern is not over the type or the specific amount of the tax which the defendant has evaded, but whether he has willfully attempted to evade the payment or assessment of a tax. *Goldberg, supra,* 330 F.2d at 40; *Simon, supra,* 248 F.2d at 876.

The difficulty in *automatically* applying the constructive distribution rules to this case is that it completely ignores one essential element of the crime charged: the willful intent to evade taxes, and concentrates solely on the issue of the nature of the funds diverted. That latter aspect is not the important element. Where the taxpayer has sought to conceal income by filing a false return, he has violated the tax evasion statutes. It does not matter that that amount could have somehow been made non-taxable if the taxpayer had proceeded on a different course.[12] To apply the constructive distribution rules to this situation would nullify all of the taxpayer's prior unlawful acts.

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demonstrate a lack of earnings and profits so as to fall within his own theory. Third, in *Leonard,* the burden of going forward is said to be transferred to the defendant once the government establishes that he has received unreported funds. In the present case, the appellant argued that the government must show that there were no earnings and profits. According to *Leonard,* he is mistaken in that contention. The trial court here found that the corporate books were so confused that a determination as to the presence or absence of earnings and profits could not be made. Consequently, even if *Leonard* were applicable, it would not support a reversal of the appellant's conviction on the false tax return counts.

[12]At the time the funds are initially diverted, it might well be argued that they could constitute either income or a return of capital. However, once the taxpayer has assumed control of the funds and then fails to report such funds as income or to make any adjustments in the corporate books to reflect a return of capital, he has already violated the tax evasion statutes. *Accord, Spies* v. *United States,* 317 U.S. 492, 498-99 (1943); *United States* v. *Swallow,* 511 F.2d 514, 521 (10th Cir.), *cert. denied,* 423 U.S. 845 (1975).

If constructive distribution rules were automatically applied, an anomalous situation would result. A taxpayer who diverted funds from his close corporation when it was in the midst of financial difficulty and had no earnings and profits would be immune from punishment (to the extent of his basis in the stock) for failure to report such sums as income; while that very same taxpayer would be convicted if the corporation had experienced a successful year and had earnings and profits. Such a result would constitute an extreme example of form over substance. In addition, it would sanction the diversion and non-reporting of corporate and personal funds, contrary to the intent and express language of the statutes. We therefore conclude that whether diverted funds constitute constructive corporate distributions depends on the factual circumstances involved in each case under consideration.

In holding that the constructive distribution rules should not automatically be applied, it is not herein asserted that diverted funds could never be a return of capital. However, to constitute the latter, there must be some demonstration on the part of the taxpayer and/or the corporation that such distributions were intended to be such a return.[13] To hold otherwise would be to permit the taxpayer to divert such funds and if not caught, to later pay out another return of capital; or if caught, to avoid conviction by raising the defense that the sums were a return of capital and hence non-taxable.

In considering the trial judge's determination that the $197,000.00 constituted additional salary, it is noted that, on appeal of a conviction in a criminal case, the evidence must be considered in a light most favorable to upholding the verdict (in this case for the government) and the findings of a trial judge cannot be set aside unless clearly erroneous. *Glasser* v. *United States,* 315 U.S. 60, 80 (1942); *United States* v. *Glover,* 514 F.2d 390, 391 (9th Cir. 1975); *United States* v. *Hood,* 493 F.2d 677, 680 (9th Cir.), *cert. denied,* 419 U.S. 852 (1974).

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[13]The government establishes a *prima facie* case when it demonstrates that the taxpaper had unexplained funds which could be considered as income which the taxpayer fails to report in his return. *United States* v. *Garcia,* 412 F.2d 999, 1001 (10th Cir. 1969); *Gendelman* v. *United States,* 191 F.2d 993, 996 (9th Cir. 1951), *cert. denied,* 342 U.S. 909 (1952).

Several factors were presented which support the conclusion that the $197,000.00 can be considered as additional salary. ***First,*** Miller admitted that he himself was not a shareholder but that the shares were in his children's names. Consequently, the only capacity in which Miller was entitled to receive the diverted funds was as an employee-officer of the corporation. While there are cases wherein the receipt of distributions from the corporation by a relative of the shareholder is considered to be a constructive distribution, *see e.g., Harry L. Epstein,* 53 T.C. 459 (1970), such cases are civil tax proceedings. As discussed above, the application of theories established in civil tax cases to problems in criminal tax cases cannot always be made. Where the taxpayer creates and uses a corporation, he cannot readily expect a court to disregard the situation which he has created when it becomes inconvenient for him. *Cf. Harrison Property Management Co., Inc. v. United States,* 475 F.2d 623, 626-27 (Ct. Cl. 1973), *cert. denied,* 414 U.S. 1130 (1974).

Second, Miller has admitted that he ordered the "scrambling" of the corporate books so that one cannot tell from the records exactly what the payments were intended to be. When the taxpayer has by his own wrongful actions created a situation where certain payments are open to several interpretations, he cannot complain if the conclusion of the trier-of-fact differs from his own, if there is a reasonable factual basis for the decision.[14]

Third, at trial, Miller presented no concrete proof that the amounts were considered, intended, or recorded on the corporate records as a return of capital at the time they were made. In

[14]Miller argues that his expert witness had no difficulty in reading the corporate books. However, the expert witness merely testified that from his study of the books he concluded that Covina had no earnings and profits. From that initial conclusion (which is contrary to that of the government's witness), he made the quantum leap that the distributions therefore had to be returns of capital. As discussed above, that syllogism is not necessarily correct. Nowhere in his testimony does the expert witness give examples that the payments were ever intended to be, or recorded in the corporate books at the time they were made as returns of capital. Alternatively, it is also noted that the trial court need not have accepted the expert witness's statements as being correct, especially in light of contrary testimony by the government's expert witness.

fact, the payments were recorded as "repayments of loans," which were shown later to be non-existent and false. Such an effort to disguise an allegedly non-taxable event (which a return of capital would normally be) raises doubts as to any claim by the defendant that he considered them to be a return of capital.[15]

Finally, the trial judge found Miller's set salary to be too small for the years in question. The judge noted Miller's responsibilities and control of the corporation and the amount and volume of business which it did. The conclusion that Miller's set salary was too small, so that the $197,000.00 could be considered as additional salary, is not clearly erroneous.

Miller in his brief before this Court states that the "almost exclusive issue on appeal" is the question of the treatment of the diverted funds to him. Appellant's Reply Brief, p. 1. That assessment is essentially correct.

We agree with the trial court's holding that the $197,000.00 of diverted funds constituted additional salary to the defendant. As to the other counts, there was substantial evidence to demonstrate (1) that Miller sought to evade the payment of taxes in violation of 26 U.S.C. § 7201 on said funds, as well as on the other sums which he diverted from Covina; (2) that pursuant to such evasion, Miller caused to be prepared and subscribed false returns for Covina, his wife and himself, and the latter

[15]The trial judge noted defendant's argument that the concealment of the income (and subsequent notation of the repayments as returns of loans) was made solely to hide the sums from creditors. However, the government through its revenue statutes is also a creditor. There was no evidence presented at trial, other than Miller's self-serving statements, that he distinguished between the government and his other creditors, or that he intended to fulfill his obligations to any of them. Moreover, as observed by the trial judge, the recording of the payments as returns of loans rather than either income (salary) or return of capital really had ramifications only to one creditor, the government. The other creditors could attach those sums despite their categorization. However, the government cannot collect taxes, either from funds which are gross income (salary) or capital gains (return of capital in excess of the basis of the stock), if the taxable income is successfully disguised as non-taxable items.

two's joint tax return as proscribed by 26 U.S.C. § 7206(1);[16] (3) that he used the U.S. Postal Service to send and deliver the false returns in violation of 18 U.S.C. § 1341;[17] and (4) that he filed or caused to be filed claims for tax refunds knowing full well that such claims were fraudulent in violation of 18 U.S.C. § 287. Consequently, the defendant's conviction on each of the 22 counts is AFFIRMED.

[16]While not argued by the appellant, we note that count 14 (Mrs. Miller's tax return for 1968) should have charged a violation of 26 U.S.C. § 7206(2) (assisting in the preparation of a false return) rather than 26 U.S.C. § 7206(1) (subscribing a false return). However, such error is not fatal where the indictment, as here, contains the elements of the offense intended to be charged, sufficiently apprises the defendant of what he must be prepared to meet, and is detailed enough to assure against double jeopardy. *United States v. Miller,* 491 F.2d 638 (5th Cir.), *cert. denied,* 419 U.S. 970 (1974).

[17]Again, after briefs had been filed but prior to oral argument, appellant's counsel cited to us the case of *United States v. Henderson,* 386 F. Supp. 1048, 1050-1054 (S.D.N.Y. 1974) for the proposition that the mail fraud statute was not intended by Congress to apply to a scheme to defraud the United States in an attempt to evade the payment of taxes. *Henderson* is inconsistent with at least three other circuit court cases which have held that the mailing of false *state* tax returns constituted a violation of 18 U.S.C. § 1341. *See, United States v. Brewer,* 528 F.2d 492 (4th Cir. 1975); *United States v. Mirable,* 503 F.2d 1065, 1066-1067 (8th Cir. 1974), *cert. denied,* 420 U.S. 973 (1975); *United States v. Flaxman,* 495 F.2d 344, 348-349 (7th Cir.) *cert. denied,* 419 U.S. 1031 (1974). We reject the holding in *Henderson.*

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STATUTES AND CONSTITUTIONAL PROVISIONS INVOLVED

United States Code, Title 18:

Section 287 declares:

False, fictitious or fraudulent claims

Whoever makes or presents to any person or officer in the civil, military, or naval service of the United States, or to any department or agency thereof, any claim upon or against the United States, or any department or agency thereof, knowing such claim to be false, fictitious, or fraudulent, shall be fined not more than $10,000 or imprisoned not more than five years, or both.

Section 1341 declares:

Frauds and swindles

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such

scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Post Office Department, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

United States Code, Title 26:

Section 61 declares:

Gross income defined

(a) General definition.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance

payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

Section 301 declares:

Distribution of Property.

(a) IN GENERAL– Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c). Source: Sec. 22(e), 1939 Code.

(b) AMOUNT DISTRIBUTED.–

(1) GENERAL RULE– For purposes of this section, the amount of any distribution shall be–

(A) NONCORPORATE DISTRIBUTEES.– If the shareholder is not a corporation, the amount of money received, plus the fair market value of the other property received.

. . .

(c) AMOUNT TAXABLE.—In the case of a distribution to which subsection (a) applies—

(1) AMOUNT CONSTITUTING DIVIDEND.—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

(2) AMOUNT APPLIED AGAINST BASIS.—That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.

(3) AMOUNT IN EXCESS OF BASIS.—

(A) IN GENERAL.—Except as provided in subparagraph (B), that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock shall be treated as gain from the sale or exchange of property.

. . .

Section 316 declares:

Dividend Defined.

(a) GENERAL RULE.— For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

. . .

Section 317 declares:

Other Definitions.

(a) PROPERTY.—For purposes of this part, the term "property" means money, securities, and any other property; except that such term does not include stock in the corporation making the distribution (or rights to acquire such stock).

. . .

Section 7201 declares:

Attempt to evade or defeat tax

Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

Section 7206 declares:

Fraud and false statements

Any person who—

(1) Declaration under penalties of perjury.—Willfully makes and subscribes any

return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material mater; or . . . .

United States Constitution

Amendment V declares:

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

†

STATE OF CALIFORNIA)
) ss.
County of Orange)

I, the undersigned, say: I am and was at all times herein mentioned, a citizen of the United States and employed in the County of Orange, State of California, over the age of eighteen years and not a party to the within action or proceeding; that

My business address is 326½ Main Street, Huntington Beach, California 92648, that on DECEMBER 8th, 1976, I served the within PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT – Marvin Miller vs. United States of America – on the following named party by depositing three copies thereof, enclosed in a sealed envelope with postage thereon fully prepaid, in the United States Post Office in the City of Huntington Beach, California, addressed to said party as follows:

Solicitor General of the United States
U. S. Department of Justice
Washington, D. C. 20530

I declare under penalty of perjury that the foregoing is true and correct.

Executed on DECEMBER 8th, 1976, at HUNTINGTON BEACH, CALIFORNIA.

D. A. Standefer

41 COPIES TO THE UNITED STATES SUPREME COURT, U. S. SUPREME COURT BUILDING, WASHINGTON, D. C. 20543

Dean-Standefer, 326½ Main St., Huntington Beach, Ca. 92648
(714) 536-7161

Supreme Court, U. S.
FILED
MAR 7 1977
MICHAEL RODAK, JR., CLERK

No. 76-790

In the Supreme Court of the United States

OCTOBER TERM, 1976

MARVIN MILLER, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

DANIEL M. FRIEDMAN,
Acting Solicitor General,

MYRON C. BAUM,
Acting Assistant Attorney General,

CHARLES E. BROOKHART,
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Attorneys,
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Washington, D.C. 20530.

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The district court did not issue a written opinion. The opinion of the court of appeals (Pet. App. A) is reported at 545 F. 2d 1204.

JURISDICTION

The judgment of the court of appeals was entered on November 10, 1976. The petition for a writ of certiorari was filed on December 10, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether proof that petitioner diverted to his own use $860,000 of the gross receipts of his wholly-owned corporation, that he did not report such sums on his tax returns, that his basis in the stock of the corporation had

been only $128,000, and that his stated salary was low in relation to his management responsibilities, was sufficient to support his conviction for income tax evasion and filing of a false return, even though there was no evidence that the corporation had any earnings and profits.

2. Whether the mailing of a false federal or state income tax return constitutes mail fraud in violation of 18 U.S.C. 1341.

STATEMENT

After a trial in the United States District Court for the Central District of California, petitioner was found guilty of six counts of mail fraud, in violation of 18 U.S.C. 1341; five counts of income tax evasion, in violation of 26 U.S.C. 7201; seven counts of filing a false income tax return, in violation of 26 U.S.C. 7206(1); and four counts of filing a false claim against the United States, in violation of 18 U.S.C. 287 (Pet. App. A 1-3, 5). The trial court sentenced him to concurrent three-year prison terms on each of 11 counts, and concurrent three-year prison terms on the remaining 11 counts, with the term in the second group of counts to run consecutively with the term in the first group of counts. The court also specified, in accordance with 18 U.S.C. 4208(a)(2), that petitioner could become eligible for parole at such time as the parole board might determine (R.T. 1301).[1]

The pertinent facts are as follows: During the period January 1, 1968, to June 1, 1970, petitioner operated Covina Publications, Inc., the business of which was the sale of "adult" books, films and devices to the general public by mail order and to wholesale distributors.

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[1] "R.T." refers to the reporter's transcript.

Petitioner dominated and controlled Covina. He purchased all of Covina's issued stock for $128,000, and the stock was held in the names of his wife and four children (Pet. App. A 2-3).

The evidence at trial showed that for Covina's taxable year ended May 31, 1969, approximately $562,000 of receipts were not recorded as sales on its corporate books or reported on the corporate tax returns filed by petitioner. For Covina's taxable year ended May 31, 1970, approximately $298,000 likewise was omitted. The evidence further showed that most of the omitted receipts were deposited in various business and personal bank and savings accounts established by petitioner under various names, including those of his wife and children. The receipts diverted by petitioner were recorded on Covina's books either as loans from petitioner or from banks, or as intercompany transfers (Pet. App. A 3-4).

During the period May 31, 1968 to May 31, 1970, petitioner received, in addition to his salary, various economic benefits from Covina. For example, Covina paid virtually all of petitioner's personal obligations. The total of such payments was in excess of $197,000, and was recorded on Covina's books as repayment of loans. Petitioner did not report any of these payments on his tax returns (Pet. App. A 4).

At trial, petitioner admitted that he had instructed his accountant to "scramble" the corporate books. However, he later testified that his sole purpose in distorting the corporate books was to conceal his income from his creditors and not to cheat the government (Pet. App. A 4).

For its taxable year ended May 31, 1969, Covina reported a net loss of $216,000. At trial, an expert witness testified on behalf of petitioner that the loss for that year should have

been $681,000. For its taxable year ended May 31, 1970, Covina reported a net loss of $697,000 (Pet. App. A 4).

ARGUMENT

1. Petitioner argues (Pet. 6-13) that he was improperly convicted of tax evasion and filing false income tax returns because the amounts of Covina's gross receipts that he diverted to his own use could not be taxed to him as dividends in the absence of any evidence that Covina had "earnings and profits" within the meaning of Section 316 of the Internal Revenue Code of 1954 (26 U.S.C.). But the existence of earnings and profits was not an indispensable element of proof of petitioner's offenses. The court of appeals agreed with "the trial court's holding that the $197,000.00 of diverted funds constituted additional salary to the [petitioner]" (Pet. App. A 15). Since additional salary was taxable to petitioner even if Covina had no earnings and profits, petitioner was properly convicted of tax evasion and filing false income tax returns.

In support of the conclusion that petitioner received $197,000 of additional salary, the court of appeals noted that the trial judge found petitioner's set salary to be too small given his responsibilities and the volume of the business he directed (Pet. App. A 15). Moreover, the amounts were not recorded on the corporate books as returns of capital, as petitioner contended, but as repayments of loans which were shown to be non-existent. Since petitioner admitted that he ordered the "scrambling" of the corporate books, the trial judge was amply justified in rejecting petitioner's claimed defense that the payments were returns of capital.

It is true that if Covina had no earnings and profits, the $860,000 diverted to petitioner would not have been taxable as a dividend. The payments instead would have been

treated as a return of capital. But the amount by which a return of capital exceeds a taxpayer's basis is taxable at capital gains rates. See Section 301(c)(3) of the Code. Petitioner's basis in the Covina stock was only $128,000 (see Pet. App. A 6, n. 7). Thus even under his theory he would have recognized over $700,000 in capital gains. Since petitioner failed to report any part of this amount, he was guilty of tax evasion and of filing a false return once he filed his tax return omitting the payment from income. See *Sansone* v. *United States*, 380 U.S. 343, 354; *United States* v. *Swallow*, 511 F. 2d 514, 521 (C.A. 10), certiorari denied, 423 U.S. 845.

2. Since petitioner's conviction stands even in the absence of earnings and profits of Covina, *a fortiori* it was not necessary for the prosecution to present evidence as to whether such earnings and profits existed. In any event, contrary to petitioner's claim (Pet. 6-8), there is no conflict of decisions on the question of the burden of proof with respect to earnings and profits. When the existence of earnings and profits is a necessary element of the offense, the ultimate burden of proof rests with the government. But where, as here, a shareholder diverts corporate receipts to his own use, the decision below correctly held that the government established a *prima facie* case of income tax evasion and that petitioner had the burden of coming forward with the defense that the amounts were not taxable, either because the corporation had no earnings and profits or for some other reason. Accord: *Davis* v. *United States*, 226 F. 2d 331 (C.A. 6), certiorari denied, 350 U.S. 965; *Hartman* v. *United States*, 245 F. 2d 349, 353 (C.A. 8); *United States* v. *Goldberg*, 330 F. 2d 30, 38 (C.A. 3), certiorari denied, 377 U.S. 953.

The burden of coming forward in such a case with evidence that there were no earnings and profits is no

different than the burden of refuting the government's net worth computation in a criminal tax prosecution. In that connection, this Court in *Holland* v. *United States*, 348 U.S. 121, 138-139, observed:

> Nor does this rule shift the burden of proof. The Government must still prove every element of the offense beyond a reasonable doubt though not to a mathematical certainty. The settled standards of criminal law are applicable to net worth cases just as to prosecutions for other crimes. Once the Government has established its case, the defendant remains quiet at his peril.

None of the cases cited by petitioner (Pet. 6-7) are in conflict with the decision below. As the court of appeals correctly observed (Pet. App. A 11, n. 11), *United States* v. *Leonard*, 524 F. 2d 1076 (C.A. 2), certiorari denied, 425 U.S. 958, is in accord with its decision and does not adopt petitioner's contention that the government must prove the existence of earnings and profits. Indeed, in upholding the conviction in *Leonard*, the Second Circuit stated: "Although the ultimate burden of persuasion remains with the Government, Leonard did not introduce sufficient evidence of an absence of earnings or profits to warrant submission to the jury of a claim [to that effect]" (524 F. 2d at 1083).[2]

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[2]Neither *Currier* v. *United States*, 166 F. 2d 346 (C.A. 1), nor *Bernstein* v. *United States*, 234 F. 2d 475 (C.A. 5), certiorari denied, 352 U.S. 915, supports petitioner's argument that the government must initially come forward with proof of the existence of earnings and profits. In upholding a tax evasion conviction in similar circumstances, the court in *Currier* did not address the question of the burden of coming forward but simply recognized that dividends are taxable only if paid out of earnings and profits (166 F. 2d at 348). *Bernstein* likewise is inapposite. There, the court rejected the defendant's efforts to reduce the corporate earnings and profits by the amount of a fraud penalty that the Commissioner subsequently imposed (234 F. 2d at 482).

3. Petitioner also contends (Pet. 13-14) that the mailing of false federal and state income tax returns does not constitute mail fraud under 18 U.S.C. 1341. But as the court of appeals pointed out (Pet. App. A 16, n. 17), other circuits also have upheld convictions under 18 U.S.C. 1341 for mailing false tax returns. *United States* v. *Flaxman*, 495 F. 2d 344 (C.A. 7), certiorari denied, 419 U.S. 1031; *United States* v. *Mirabile*, 503 F. 2d 1065 (C.A. 8), certiorari denied, 420 U.S. 973. See also *United States* v. *Brewer*, 528 F. 2d 492 (C.A. 4). Contra: *United States* v. *Henderson*, 386 F. Supp. 1048, 1050-1054 (S.D. N.Y.).

Moreover, the fact that a particular fraudulent scheme involving use of the mails also violates another federal statute has been held not to be a bar to prosecution under the mail fraud statue. *Pereira* v. *United States*, 347 U.S. 1, 8-9 (National Stolen Property Act); *Edwards* v. *United States*, 312 U.S. 473, 483-484 (Securities Act of 1933); *United States* v. *Brewer, supra*, 528 F. 2d at 497-498. Nothing in the broad language of 18 U.S.C. 1341—"any scheme or artifice to defraud"—suggests that Congress intended to exclude mailing a false federal or state tax return from its coverage.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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